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Supreme Court of the United States

OCTOBER TERM, 1978

No. 78-1483

FREDERICK M. FRIEDMAN,
Petitioner,

—against—

UNITED STATES OF AMERICA,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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No.

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—against—

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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

Petitioner Frederick M. Friedman respectfully requests that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Second Circuit entered on September 14, 1978.

Opinions Below

Copies of the opinion originally rendered by the Court of Appeals (including a concurring opinion of Judge Mansfield), not get officially reported but unofficially reported at

CCH Fed. Sec. Rep. Par. 96,552; the Court of Appeals' "corrected" opinion; the judgment of the Court of Appeals; the Court of Appeals' decision on petitioner's petition for rehearing and suggestion for rehearing in banc; and the memorandum opinion of the United States District Court for the Southern District of New York (not yet officially reported but unofficially reported at CCH Fed. Sec. Rep. ¶ 96,074), are printed in the Appendix being submitted simultaneously by all petitioners in this matter.

Jurisdiction

The judgment of the Court of Appeals, entered September 14, 1978, was stayed by petitioner's timely filing of a petition for rehearing with suggestion for rehearing in banc. This petition was denied by Order of the Court of Appeals entered February 14, 1979, except that the Court of Appeals did, in response to the petition, correct certain "errors" in its original opinion (discussed *infra*, pp. 26-30). By Orders dated February 26, 1979 and March 7, 1979, the Court of Appeals stayed issuance of its mandate until March 26, 1979 in order to permit the filing by that date of this petition for a writ of certiorari. This Court, by Order of the Hon. Thurgood Marshall, extended until March 26, 1979 the date for filing of this petition. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

Questions Presented

1. Whether the Court of Appeals correctly held, in direct conflict with the United States Court of Appeals for the First Circuit in *United States* v. *Rodman*, 519 F.2d 1058 (1st Cir. 1975), that a District Court is without any

supervisory power to dismiss an indictment where the indictment results from undisputed fraudulent misconduct perpetrated by SEC attorneys upon the target of an investigation and where no remedy for that fraud other than dismissal of the indictment is possible.

2. Whether the due process clause of the Fifth Amendment to the United States Constitution, which has been held by this Court to require all governmental agencies to abide by their own published regulations, requires dismissal of an indictment where the indictment results from the SEC's criminal reference of a matter in clear-cut violation of its own published regulations.

3. Whether a Court of Appeals may reject a critical stipulation of fact agreed to by all parties in both the District Court and the Court of Appeals, where neither party requests to be relieved of that stipulation and where no evidence suggests any inaccuracy in that stipulation.

4. Whether the Court of Appeals was correct in holding that under this Court's decision in *TSC Industries* v. *Northway,* 426 U.S. 438 (1976), counts of an indictment (Counts 1-3) charged a federal offense under Section 17a of the Securities Act of 1933 and Section 1001 of Title 18, U.S.C., despite the absence of any connection between the alleged corporate misconduct and the offer and sale of the TDA securities and despite the charge in the indictment that the shareholders alleged to have been defrauded were sellers and not purchasers of the securities.

5. Whether the Court of Appeals was correct in holding that a count of the indictment (Count 4) charging a proxy violation under Section 14a of the Securities Exchange Act of 1934 by the omission of alleged corporate misconduct charged a federal offense despite the absence of any "transaction causation" between the alleged misconduct and the purposes for which the proxy was solicited.

Statutory and Regulatory Provisions

All relevant statutes and administrative regulations are set forth in the appendix annexed to co-petitioner Fields' petition.

Prior Proceedings in the Courts Below

By indictment filed November 8, 1976 petitioner and others were charged with various violations of the federal securities laws. Petitioner (and his co-defendants) filed pre-trial motions seeking dismissal of the indictment and alternatively dismissal of certain portions of the indictment. Among the grounds raised in support of the motion to dismiss was petitioner's contention that events that occurred during the course of an investigation by the Securities and Exchange Commission (hereinafter "SEC") into the matters that formed the basis of the indictment warranted dismissal. The District Court held an eleven-day pre-trial hearing on this motion, after which it granted petitioner's motion, based on the fraudulent misconduct of the SEC's attorneys. Portions of the indictment against petitioner were also dismissed on alternative grounds*.

The main ground relied upon by the District Court in dismissing the indictment against petitioner was that SEC attorneys, in settlement negotiations with counsel for peti-

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* The effect of the District Court's decision was dismissal of the indictment in its entirety against petitioner and two of his co-defendants, while leaving intact three counts against co-defendant Fields carrying maximum sentences of five years' imprisonment on each count plus fines of $5,000. and $10,000., and exposing co-defendant Berge to trial on one count carrying a maximum sentence of five years' imprisonment plus a $10,000. fine.

tioner and his co-defendants arising out of an investigation concerning the matters that gave rise to this indictment, "behaved improperly" and engaged in a "deplorable" course of conduct of "misleading counsel" and because "the SEC representatives in question engaged upon a deliberate course of concealment, first of their intention to make a criminal reference, and then of the fact that the reference had been made, in order to obtain civil consent judgments imposing substantial sanctions upon the defendants"; the District Court further observed, "It is a sad irony that representatives of a governmental agency dedicated to the prevention of fraudulent and misleading statements fell into this particular pattern of behavior." (34a*-36a). The Government moved for rehearing and reconsideration, and the District Court, while granting rehearing and reconsideration, adhered to its original decision (75a et seq.).

The Government appealed. The United States Court of Appeals for the Second Circuit reversed, rejecting all grounds which the District Court had relied upon in dismissing the indictment (79a et seq.). Circuit Judge Mansfield, in a concurring opinion, recognized that the conduct of the SEC attorneys was "deceitful and duplicitous" and violated an "ethical obligation" owed to petitioner and his co-defendants (104a-105a). In addition, the Court of Appeals sustained the District Court's rejection of one ground which petitioner had urged for dismissal in the District Court, *i.e.*, that the SEC's criminal reference of this case to the United States Attorney's Office in viola-

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* The letter "a" preceded by a number designates page reference to the Appendix being filed simultaneously by all petitioners in this matter.

tion of the SEC's published regulations governing criminal references required dismissal of the indictment.*

Petitioner filed a petition for rehearing and suggestion for rehearing in banc. In response thereto, the SEC filed a memorandum amicus curiae which advised the Circuit Court, as the United States Attorney's Office had earlier done by letter immediately after the Circuit Court had rendered its opinion, that the criminal reference procedure as described and relied upon in the Court of Appeals' decision misinterpreted the record and was in other respects materially wrong. The SEC suggested a series of substantive revisions "of language" in the Court of Appeals' opinion. The Court of Appeals, while denying the petition for rehearing, made the corrections urged by the SEC *in haec verba* (108a et seq.).

Statement of Facts

The District Court, after conducting a lengthy evidentiary hearing, made extensive findings of fact (set forth at 7a-25a). The Government on appeal did not seek to set aside any of those findings of fact. The Court of Appeals purported to "assume, without deciding, the correctness of the district court's findings."** As the Dis-

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* Petitioner raised this ground in the Circuit Court pursuant to the rule that "the prevailing party may, of course, assert in a reviewing court any ground in support of his judgment, whether or not that ground was relied upon or even considered by the trial court." *Dandridge* v. *Williams,* 397 U.S. 471, 475, n.6 (1970).

** 85a, n. 5. In determining the petition for rehearing, however, the Court of Appeals implicitly rejected one crucial such finding with respect to the SEC's criminal reference of this case, notwithstanding that finding having been stipulated to by the parties and having been unequivocally found by the District Court; see Point 4, *infra.*

rict Court's findings are succinctly set forth in its opinion they will not be restated herein. Rather petitioner respectfully refers this Court to those findings as the factual basis upon which this petition is based. Familiarity with those factual findings is hereinafter respectfully assumed.

Reasons for Granting the Writ

1. The Court of Appeals' decision conflicts with the decision of the United States Court of Appeals for the First Circuit in *United States* v. *Rodman*, 519 F.2d 1058 (1st Cir. 1975) on the issue of whether a District Court may, in the proper exercise of its supervisory powers, dismiss an indictment where the indictment results from misconduct perpetrated by SEC attorneys upon the target of an SEC investigation.

The gross extent of the fraud perpetrated by the SEC's attorneys* is highlighted by the following undisputed findings of fact:

1. At the first meeting and at the subsequent meetings between petitioner's counsel (Gould) and the SEC's attorneys, Gould made the SEC attorneys "fully aware that defendants' counsel had as one of their two primary objectives the avoidance of a criminal reference. . . . Gould

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* Both SEC attorneys involved, Tucker and Perlmutter, were more than low-level functionaries at the time of their misconduct. "Tucker, although reporting to his superiors at the New York regional office, was in operational command of the inquiry. Perlmutter was his top assistant." (See District Court's finding of fact #20). During the course of the SEC's investigation in this case, Tucker became acting assistant regional administrator of the SEC's New York Regional Office and Perlmutter became a branch chief (pp. 545-547 of Joint Appendix in Court of Appeals).

again made clear to the SEC representatives that one of his primary concerns was to avoid a criminal reference* in respect to his individual clients (petitioner and co-defendants Fields and Davis)" (F**16, 19, 24).

2. "On June 17, 1975, in separate telephone conversations, Tucker advised Gould and Kantor that the SEC investigation was almost concluded; and that it appeared that the January 14 disclosures had been substantially complete and accurate." (F 21).

3. The minutes of the meeting of TDA's board of directors for July 18, 1975 state, *inter alia*:

> "Mr. Kantor reported that on June 17, 1975, a member of the SEC staff had informed him that their investigation was 95 per cent complete and that his staff would not refer the matter for criminal prosecution." (JA***401).

Fields and Friedman were present at this meeting and heard the statement (JA 475).

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* Testimony was given at the District Court hearing by William Nortman, Esq., who at the time of the SEC's TDA investigation was Assistant Regional Administrator of the New York Regional Office and at the time of the hearing was Associate Regional Administrator of the SEC's Atlanta Regional Office, that such negotiations —a negotiated civil settlement on the understanding concurred in by the SEC that the SEC would not make a criminal reference— were appropriate and proper at the staff level. (See pp. 743-747 of Joint Appendix in Court of Appeals).

** The letter "F" followed by a number designates reference to the District Court's numbered findings of fact (all of which are set forth at 7a-25a).

*** The letters "JA" followed by a number indicate page reference to the Joint Appendix in the Court of Appeals.

4. Petitioner (and co-defendant Fields) resisted the settlement terms initially demanded by the SEC, but were told by Gould "in response to their resistance that if Fields and Friedman did not authorize him to attempt to settle the case on the terms recommended by Gould, then the SEC would not be bound by the agreement which, in Gould's expressed view, it had made with them not to make a criminal reference." (F 25).

5. On September 16, 1975, the SEC filed its civil complaint. Gould believed this violated an agreement he had reached with Perlmutter that its filing would be deferred until the consent then being negotiated could be finalized and filed with the complaint. Gould angrily upbraided Perlmutter, and Perlmutter became "upset at the incident." (F 26).

6. Shortly after being upbraided by Gould, Perlmutter telephoned Assistant United States Attorney Sorkin "to urge that the United States Attorney's office 'investigate the TDA matter.' Perlmutter said that 'we really want to get TDA', but advised Sorkin that he first wanted to 'wrap up' the civil settlement before the United States Attorney began its own inquiry. Perlmutter made several other calls to Sorkin, of similar import, during October and November." (F 32).

7. On September 30, after Gould became ill and Judge Streit, his law partner, took over the representation of petitioner (and of co-defendant Fields), Judge Streit met with Tucker and Perlmutter. At this meeting the SEC attorneys announced that the money they would insist the defendants pay to TDA in order to settle the case had escalated to $585,000.00. "Judge Streit responded that it was a 'horrendous' amount, and there were serious questions concerning some of the figures, 'but in light

of the fact that there is to be no criminal prosecution I shall endeavor to obtain the money for you' (Tr. 150-153)." (F 27).

8. "Tucker and Perlmutter remained silent in the face of [Judge] Streit's comment." (F 27).

9. "[Judge] Streit reported this meeting to Fields, Friedman and Davis, including the above-quoted statement that had been made by Judge Streit to which the SEC representatives had not responded." (F 28).

10. At subsequent meetings over the next several months among Fields, Friedman, Davis, and their attorneys, "Fields, Friedman and Davis resisted the terms that the SEC was demanding for settlement of the civil case. However, their resistance was overcome by their attorneys' advice to them that the SEC had agreed that if a satisfactory settlement was made of the civil action, there would be no criminal reference." (F 28).

11. After Gordon, attorney for Mosler, was told separately by Fields and by Kantor that as part of the settlement the SEC had agreed not to make a criminal reference, Gordon scheduled a meeting with Perlmutter for the specific purpose of confirming it. At that meeting "Gordon advised Perlmutter that he represented Mosler, and stated to Perlmutter, among other things, that in deciding whether to accept a directorship in TDA it was important for Mosler to know whether there was going to be a criminal reference of the case. Gordon further stated to Perlmutter that Gordon understood there was not going to be a criminal reference. Perlmutter assured Gordon that there was not going to be a criminal reference. Gordon thereafter reported Perlmutter's assurance to Mosler and to Fields." (F 29).

12. Tucker and Perlmutter falsely testified at the hearing that the conversation to which Gordon testified did not occur (JA 575, SA*21). The Court expressly rejected their denials (F 29, JA 68). Tucker and Perlmutter also testified falsely at the hearing when they swore that Gould had been specifically told that there was "no deal on criminal". (F 24).

13. When Ostrow, counsel for co-defendant Sandberg, concluded he could not persuade Tucker and Perlmutter to pursue lightly, if at all, the complaint against Sandberg, "Ostrow agreed to recommend that Sandberg enter into a settlement, stating to Tucker and Perlmutter that settling would be 'better than going over to the golden dome', a reference to the United States Courthouse across the street from and visible from the window of the SEC's office. Ostrow's reference to 'going over to the golden dome' was intended by Ostrow to be a reference to facing a federal indictment. Under the circumstances, it was undoubtedly so understood by Tucker and Perlmutter, who chuckled at the statement but said nothing." (F 31).

14. On December 1, Gould and Judge Streit met with Tucker and Perlmutter to discuss the collateralization of petitioner's (and his co-defendants') substantial financial obligations under the settlement then in its final stages, and Gould told them they had "got a great settlement, take it". Right after Gould left, Tucker referred the case to the United States Attorney's Office (F 33; JA 205).

15. "At the time he made the criminal reference of the TDA case, Tucker knew that avoidance of a criminal reference was one of two primary objectives for Fields and

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* The letters "SA" followed by a number designate page reference to the Supplemental Appendix filed in the Court of Appeals.

Friedman in the civil settlement negotiations (the other being their retention as corporate officers), and the only objective for Davis, an attorney who was not an officer . . . Notwithstanding that knowledge, Tucker at no time disclosed to counsel for these defendants that a criminal reference had in fact been made. That non-disclosure was calculated and deliberate, not inadvertent. Tucker testified that he did not want to do anything that would jeopardize the civil settlement (Tr. 1028-1029), and that, in his view, the defendants

> ". . . believed that there would be no criminal case growing out of this and that is why they entered into a consent decree. (Tr. 1091)." (F 25) (See also JA 634-JA 636).

16. "[H]ad [Gould] known, subsequent to December 1 but before execution of the consents to judgment, that a criminal reference had in fact been made, he would have recommended to his clients that they not enter into the consents . . . Such advice would have been accepted, so that the SEC would have lost the civil settlement which Tucker's concealment of the criminal reference was specifically designed to protect." (F 37; see also F 28 and F 39).

These undisputed facts* clearly show, as the District Court found, a gross fraud perpetrated by the SEC's attorneys upon petitioner—in the words of Circuit Judge Mansfield in his concurring opinion, "deceitful and duplicitous" conduct by the SEC's attorneys in violation of

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* It is most noteworthy that the Court of Appeals' decision, while not upsetting any of the District Court's findings of fact, chose simply to ignore virtually every one of the above highlights among those findings.

their "ethical obligation" owed to petitioner. It was in light of these and other findings of fact, none of which was disputed on appeal by the Government or overtly disturbed in any respect by the Court of Appeals, that the District Court exercised what it believed to be its supervisory powers and dismissed the indictment against petitioner.

The Court of Appeals' holding that the District Court "abused its discretion" in dismissing the indictment in the exercise of its supervisory powers clearly conflicts with the decision of the United States Court of Appeals for the First Circuit in *United States* v. *Rodman,* 519 F.2d 1058 (1st Cir. 1975), which expressly held that under identical circumstances the District Court's dismissal of the indictment was *not* an abuse of the District Court's supervisory powers.

In *Rodman,* the Court of Appeals for the First Circuit affirmed as "not an abuse of the [district] court's supervisory function"* the dismissal by the District Court of an indictment where SEC attorneys had failed to honor a commitment they had made to the defendant during the SEC's investigation that they would strongly recommend that the United States Attorney not prosecute the defendant. In both *Rodman* and the instant case the indictments resulted from misconduct committed by SEC attorneys against the targets of their investigation: In *Rodman* the misconduct was the failure by an SEC attorney to honor a commitment to recommend against criminal prosecution, and here the misconduct was fraudulently inducing petitioner to consent to an extremely onerous civil settlement on the understanding that there would be no criminal reference of the case while the SEC attorneys

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* 519 F.2d at 1060.

were at the very same time referring the case for criminal prosecution. The District Court in each case dismissed the indictment in the exercise of the District Court's supervisory powers; the First Circuit Court of Appeals held this not to be an abuse of the District Court's supervisory powers and the Second Circuit Court of Appeals held this to be an abuse of those powers.

The Second Circuit's attempt to distinguish *Rodman* from this case was limited to the following purported distinction:

> "The improper conduct here certainly was not as egregious as that in *United States* v. *Rodman,* 519 F.2d 1058 (1 Cir. 1975), where the SEC not only broke its promise but obtained incriminating evidence from the defendant in reliance on that promise. Moreover, the promise there was to 'strongly recommend' against prosecution." (98a)

It is respectfully submitted that these purported distinctions are in fact non-existent and that upon analysis these factors actually underscore the sharpness of the conflict between the decisions in *Rodman* and in this case:

(a) *As to the allegedly more "egregious" wrong in Rodman.* In *Rodman,* SEC attorneys merely broke a promise to the defendant; here, SEC attorneys committed the far more serious misconduct of deliberately committing a fraud against petitioner (and his co-defendants) by knowingly, wilfully, and fraudulently inducing him to consent to extremely onerous civil sanctions based on what the SEC attorneys knew to be the understanding of petitioner and petitioner's counsel that in exchange for these onerous sanctions there would be no criminal reference of this case, while at the very same time these same SEC attorneys were continually referring the case to—indeed urging it

upon—the United States Attorney's Office for criminal prosecution. Violation of an agreement made with the target of an investigation, as occurred in *Rodman,* is no more "egregious" than is the wilful and deliberate perpetration of a fraud and deceit upon the target of an investigation, as occurred here; to the contrary, the District Court in *Rodman* did not question the SEC attorney's good faith in that case, while here the District Court repeatedly found bad faith on the part of the SEC attorneys. The courts have traditionally treated fraud as far more serious misconduct than breach of an agreement. Moreover, the fraud* committed by the SEC attorneys here was compounded by the fact (as specifically found by the District Court) that at the hearing in the District Court in this case those same SEC attorneys lied under oath concerning the events in question (JA 575, SA 21, F 24).

(b) *As to the fact that in Rodman incriminating evidence was obtained.* The *Rodman* record, which was introduced in the District Court in this case, unequivocally shows that in *Rodman* the prosecutor agreed, during the course of the pre-trial hearing on Rodman's motion to dismiss the indictment, not to use any of Rodman's statements, and that the District Court in Rodman, in addition to its order dismissing the indictment, also alternatively suppressed Rodman's statements "in case some other court disagrees with me on the matter of the motion to dismiss" (JA 165). Thus in both *Rodman* and in the instant case the defendant was not prejudiced in an evidentiary sense, in that in both cases the defendant made no statement which the Government could use against him. In fact, in *Rodman* the defendant was not prejudiced at

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* The fraud was committed not only by the SEC attorneys' fraudulent omissions but also by their affirmative fraudulent misstatements (32a).

all in view of the Government's consent to and the District Court's entry of an alternative order that all incriminating statements he had made would be suppressed. In the instant case, to the contrary, petitioner was incurably prejudiced in a very practical sense. As the District Court found "it is impossible, by reopening the civil consent judgments, to restore the individuals concerned to the positions in which they found themselves at the time of the non-disclosure of the criminal reference, in December of 1975, and the subsequent execution of the consent judgments." (38a). The onerous terms of the consent judgments, which the SEC attorneys in charge of this investigation repeatedly characterized during the District Court's hearing as "superb"*, involved payment by the defendants of over one-half million dollars** and substantial ancillary relief involving multi-year prohibitions from holding corporate office, from holding corporate directorships, from voting

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* JA601-JA611. The reason advanced by Circuit Judge Mansfield for not dissenting—that the SEC would have received the case from the District Attorney's Office had the defendants not brought it to the SEC's attention themselves—misses the mark: if that had occurred, and had the SEC attorneys not engaged in their fraud on the defendants, then the defendants would not have consented to these extremely onerous civil sanctions. In other words, the defendants did not claim they were entitled to dismissal of the indictment because they had made a voluntary disclosure to the SEC, but because the SEC attorneys had (as the District Court found) defrauded them during settlement negotiations to induce their consent to these impressive civil sanctions. The SEC's fraud would be equally outrageous even if the D.A.'s Office had referred the matter to the SEC. (Furthermore, there was no evidence that the District Attorney's Office did in fact refer this matter to the SEC.)

** An amount, as the Government conceded below, in excess of the amount which the Government itself charged the defendants with having unlawfully received.

privately owned stock, severe injunctive relief, and the like; all of the terms are set forth at 22a-23a, fn. 2.*

(c) *As to the "strong recommendation against prosecution" to be made in Rodman.* In this case as in *Rodman,* had the Government not committed its misconduct there would have been no criminal case. The Government in this case has conceded that this matter came to the attention of the United States Attorney's Office only through the criminal references by Perlmutter and Tucker (JA 8-JA 9). Thus, had the SEC not perpetrated its fraud by referring this case for criminal prosecution, as the SEC attorneys knew was the petitioner's understanding at the time petitioner agreed to the onerous civil settlement here, there would have been no criminal prosecution.

Accordingly, it is respectfully submitted that the decision by the Second Circuit Court of Appeals in this case squarely conflicts with the decision of the First Circuit Court of Appeals in *Rodman,* and that only a decision by this Court can resolve this important conflict.**

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* Moreover, as one lower court has observed, the Government should be compelled to honor commitments in the interests of "judicial integrity and the interests of justice", even where there is "no prejudice, apart from that suffered by the administration of justice." *Matter of Doe,* 410 F.Supp. 1163, 1165, 1166 (E.D. Mich. 1976).

** Significantly, other federal circuit courts of appeals, when presented with a close parallel to the issue presented by this direct conflict between *Rodman* and the instant case, have resolved the issue in favor of permitting District Courts, in the exercise of discretion, to dismiss indictments. (See, e.g., *United States* v. *Minnesota Min.*

(Footnote continued on following page)

2. The Court of Appeals' decision in forbidding a District Court to exercise its supervisory powers to remedy a fraud perpetrated by a governmental agency upon a citizen has decided an important question of federal law vital to the administration of the laws by the SEC (and other governmental agencies) and to the administration of criminal justice, a question which has not yet been but should be decided by this Court.

The importance of the conflict referred to above is manifest not only because it is a conflict but additionally because it leaves unresolved the significant issue of whether a United States District Court, when confronted with an indictment which results from fraudulent misconduct on the part of the attorneys representing governmental agencies, has the power to deter future governmental miscon-

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(Footnote continued from preceding page)

& Mfg. Co., 551 F.2d 1006, 1112 (8th Cir. 1977) ("the remedy for the breach of this promise rests in the discretion of the trial court . . . and under the circumstances of this case we cannot say that the remedy of dismissing the indictment was undue or an abuse of discretion"); *United States* v. *Carter*, 454 F.2d 426 (4th Cir. 1972), cert. denied 417 U.S. 933 (1974)); this was the result mandated by this Court in *Santobello* v. *New York*, 404 U.S. 257, 263 (1971) ("the ultimate relief to which petitioner is entitled we leave to the discretion of the state court"); and other District Courts have also exercised their discretion in analogous situations in the same manner as the District Court in this case. (See, *e.g.*, *United States* v. *Phillips Petroleum Co.*, 435 F.Supp. 622 (N.D. Okla. 1977); *United States* v. *Paiva*, 294 F.Supp. 742 (D.C. D.C. 1969)). The cases cited in this footnote are analogous, not identical (although cf. *Elkins* v. *United States*, 364 U.S. 206 (1960)), as the misconduct therein was perpetrated by the prosecuting arm of the Executive Branch; *Rodman* and the case at bar, however, are identical and indistinguishable, not merely analogous, as in both cases the misconduct was perpetrated not by the prosecuting arm of the Executive Branch, but by attorneys for the SEC. *Rodman* and this case are absolutely irreconcilable.

duct and to grant reasonable redress to wronged parties by dismissal of the indictment.

The SEC refers approximately 100 cases per year to the Department of Justice for criminal prosecution.* This Court may also judicially notice that numerous other administrative agencies have the statutory authority to, and do, refer cases to the Department of Justice for criminal prosecution. There has been no dispute at any stage in this case—by the United States Attorney's Office, by the SEC, or by the Court of Appeals—that the District Court's uncontested findings of fact clearly establish that the SEC attorneys wilfully perpetrated an outrageous fraud upon petitioner and his co-defendants. This case thus presents the question of whether when an administrative agency perpetrates such an undisputed and adjudicated fraud upon a target of its investigation, a District Court is completely powerless to dismiss an indictment where no other remedy exists which would restore petitioner to his pre-victimized status.** This is, moreover, the second reported case

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* See SEC amicus curiae memorandum in the Court of Appeals, p. 13, n. 35.

** The District Court's finding that "it is impossible, by reopening the civil consent judgments, to restore the individuals concerned to the positions in which they found themselves at the time of the non-disclosure of the criminal reference, in December of 1975, and the subsequent execution of the consent judgments" (38a) was amply justified: petitioner was prevented for the full period dictated by the the settlement from acting as director of TDA and Westcalind, from serving as a chief executive officer of TDA and Westcalind, and from voting his shares of TDA and Westcalind stock, and, of course, paid out an enormous sum of money in settlement and was subjected to other substantial injunctive relief. Nor did the Court of Appeals question this finding. Even the Government in its appellate brief in the Court of Appeals abandoned the contention it had made in the District Court that the petitioner could be "made whole" by any remedy short of dismissal of the indictment.

within the last several years in which SEC attorneys have violated their legal and ethical obligations to subjects of SEC investigations.*

The importance of resolution by this Court of this significant question concerning the extent of the supervisory powers of federal District Courts under these circumstances is highlighted by the fact that the SEC has effectively announced that it will not undertake by itself appropriate steps to prevent a recurrence of such fraudulent misconduct by its attorneys. In the Government's petition for rehearing in the District Court, the SEC advised the District Court that "on the basis of the factual findings contained in the opinion of the Court, the Commission has undertaken an independent inquiry in this matter at the conclusion of which the Commission will take all action which it deems appropriate." (JA 128). However, the SEC subsequently decided (without advising either the District Court or Circuit Court) to "defer" its inquiry until the conclusion of this very case (SA 1-SA 4). The SEC by its promise of action followed by its inaction has effectively served notice that only the exercise of judicial supervisory powers will prevent a repetition of this type of fraudulent misconduct.

Thus, the Court of Appeals' decision in this case, if permitted to stand, will not only stand in conflict with the First Circuit Court of Appeals' decision in *Rodman,* but will also result in this type of misconduct remaining uncorrected by the SEC, and will, further, be an open invitation to all Government agencies and their attorneys and other representatives to act as they wish, without any fear that their fraudulent misconduct, supported later by perjury, will be judicially dealt with in the strong

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* The other reported case being *United States* v. *Rodman, supra.*

terms such misconduct merits and which the District Court in this case (and in *Rodman*) properly invoked.

This Court has observed that

> "we may some day be presented with a situation in which the conduct of law enforcement agents is so outrageous that due process principles would absolutely bar the government from invoking judicial processes to obtain a conviction." *United States* v. *Russell,* 411 U.S. 423, 431-432 (1973).

We respectfully submit that in view of the gross fraud perpetrated by the Government agents here, this is that situation.

3. The Court of Appeals, in upholding the validity of the SEC's referral of this case to the United States Attorney's Office in violation of the SEC's published regulations governing such referrals, has contravened controlling decisions of this Court.

This Court, relying upon the due process clause of the Fifth Amendment, has often reiterated the principle that the dictates of due process require a governmental agency to comply with its own published regulations:

> "So long as this regulation is extant it has the force of law. . . . So long as this regulation remains in force the Executive Branch is bound by it, and indeed the United States as the sovereign composed of the three branches is bound to respect and to enforce it." *United States* v. *Nixon,* 418 U.S. 683, 696-697, 94 S.Ct. 3090, 3101-3102 (1974).

See also *Accardi* v. *Shaughnessy,* 347 U.S. 260 (1954); *Service* v. *Dulles,* 354 U.S. 363 (1957); *Vitarelli* v. *Seaton,*

359 U.S. 535 (1959); *Yellin* v. *United States*, 374 U.S. 109 (1963).

The Court of Appeals' decision in this case, in upholding the validity of the referral of this case by SEC attorneys to the United States Attorney's Office, plainly violated that principle. This becomes clear upon examination of (a) the statutes and administrative regulations governing such referrals and (b) the nature of the referral made in this case.

(a) *The statutes and administrative regulations governing referrals of cases by the SEC to the Department of Justice.*

The applicable statutes and administrative regulations governing referrals by the SEC to the Department of Justice are set forth in the appendix annexed to co-petitioner Fields' petition. It is only the *Commission* itself, or officials who are by duly published regulation specifically delegated by the Commission (who may in turn similarly delegate their responsibility by duly published regulation), who may make such referrals. Yet it is undisputed that neither Tucker nor Perlmutter, nor any other attorney or employee on their level, has been delegated to make such referrals.

These published regulations and their noticeable absence of any delegation of any such tremendous power to attorneys at the level of Tucker and Perlmutter are consistent with the position of the SEC as publicly and formally expressed to the House of Representatives of the United States Congress, where the SEC has assured the Congress that there is a thorough and continuing series of reviews at various "supervisory levels", conducted seriatim "by persons of increasing experience and au-

thority", and that ultimately the Commission itself, acting on recommendation of its general counsel, "must approve" the staff's recommendation before a criminal reference is made* (JA 283-JA 289).

(b) *The referral here.*

The legal mode of referrals as set forth in the statutes and regulations referred to above were wholly violated in the instant case. Here, first Perlmutter, then Tucker, referred this case to the United States Attorney's Office—without any legal authority to do so. The circumstance under which Perlmutter made the first referral is instructive of the excellent reasons why the level of referral is required legally to be by either the Commission itself or by its highly-placed and experienced formally delegated officials: shortly after having been upbraided by petitioner's counsel for having violated an agreement to defer filing of the civil complaint until a consent judgment had been finalized, Perlmutter in a pique simply telephoned a friend of his in the United States Attorney's Office "to urge that the United States Attorney's office 'investigate the TDA matter.' Perlmutter stated that "we really want to get TDA', but advised Sorkin that he first wanted to 'wrap up' the civil settlement before the United States Attorney began its own inquiry. Perlmutter made several other calls to Sorkin, of similar import . . ." (F 32).

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* This rationale comports with that of this Court in the analogous case of *United States* v. *Giordano*, 416 U.S. 505, 515 (1974), specifically enforcing an Act mandating "the mature judgment of a particular, responsible Department of Justice official . . . as a critical precondition" to permissible action.

The Court of Appeals, confronted with these facts, attempted to sustain the propriety of the criminal reference here by holding:

> "It is important to bear in mind the distinctions, under SEC procedure, between an *informal investigation* (such as that here involved) and a *formal investigation;* and between an *informal criminal reference* (such as that here involved) and a *formal criminal reference.*
>
> With respect to the investigation procedure, the *informal,* or *preliminary, investigation* which was utilized in the instant case does not require members of the staff to obtain Commission authorization before turning over public or nonpublic investigative materials to the United States Attorney's office. On the other hand, a *formal investigation* of alleged criminal violations (not utilized here), where issuance of process or compulsion of testimony is necessary, does require Commission authorization." (90a-91a; emphasis in original (footnotes omitted))

The difficulty with this line of reasoning is that its entire premise—that an informal rather than a formal investigation was being conducted by the SEC—was incontrovertibly wrong: this error was brought to the Court of Appeals' attention subsequent to its decision by the United States Attorney's Office and by the SEC itself.* The SEC's formal order of investigation had been intro-

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* The United States Attorney's Office did so by a letter dated October 10, 1978 to the Court of Appeals panel, and the SEC did so by an amicus memorandum submitted to the panel some two and a half months after petitioner's petition for rehearing in the Court of Appeals had been filed and was still pending.

duced into evidence in the District Court hearing as an exhibit. The Court of Appeals' above-quoted holding also contradicted a concession contained in the SEC's amicus memorandum that "both a formal and informal criminal reference require Commission authorization."

Thus under the undisputed facts of this case the referral by the SEC attorneys to the United States Attorney's Office violated the SEC's published regulatory scheme governing criminal references to the Department of Justice. Accordingly, under this Court's well-established holdings previously referred to that regulations validly prescribed by a governmental agency are binding law, dismissal of the indictment was mandated (and the District Court's dismissal of the applicable portions of the indictment should therefore have been affirmed) under the Court of Appeals' own reasoning. The only remedy in this case for the SEC's violation of its own published regulations in referring this case to the United States Attorney's Office is to dismantle the result of that reference, i.e., to dismiss the indictment.

The Court of Appeals avoided this result, when this critical factual error in its opinion was pointed out not only by petitioner but also by the United States Attorney's Office and by the SEC, by ignoring and impliedly rejecting a crucial and stipulated finding of fact, which will now be discussed.

4. The Court of Appeals, in "correcting" its opinion, ignored controlling decisions of this Court and conflicted with decisions of other federal Circuit Courts of Appeals which have held that a federal appellate court does not have the power to ignore and override critical facts which the parties have stipulated to and do not even on appeal dispute.

As noted above, after the Court of Appeals rendered its original opinion, in which it had acknowledged that under the applicable statutes and published SEC regulations a formal SEC investigation requires *Commission* authorization to refer a case for criminal prosecution to the United States Attorney's Office, the Government and the SEC (as well as petitioner) advised the panel in writing that the factual cornerstone of the Court's reasoning—i.e., that the SEC's investigation in this case had been an *in*formal rather than a formal one—was erroneous.

The SEC pointed out this error in an amicus memorandum, which the Court of Appeals had not requested, after petitioner's petition for rehearing had been pending for some two and a half months. In its amicus memorandum, the SEC attempted to avoid the logical consequence of the Court of Appeals' critically erroneous premise by arguing that although the SEC investigation had been formal, and although there had been no approval by the Commission or by any lawfully delegated Commission official for referral of the case to the United States Attorney's Office, and although this case reached the United States Attorney's Office only through the recommendation and active urging of SEC attorneys Tucker and Perlmutter, this referral of the case was not a "criminal reference" to the United States Attorney's Office but was merely a "preliminary communication" to that office, a concept advanced by the SEC for the first time in its

amicus presentation on appeal* and which appears neither in the statute nor in the SEC's published regulations.** The SEC therefore urged the Court of Appeals to "correct" its opinion by pointing out to that Court all references (by page and line number) to "criminal references" in the Court's opinion and suggesting the substitution of "phraseology" referring to "preliminary communications". The Court of Appeals thereupon "corrected" its opinion by adopting the SEC's proposed "corrections" *in hacc verba* (108a-111a).

Thus, with respect to the unauthorized criminal reference of this matter, the cornerstone of the Court of Appeals' opinion as "corrected" is now the statement of alleged fact that the referrals by Tucker and Perlmutter to the United States Attorney's Office were not "criminal references" but were merely "preliminary communications". But this factual premise in the Court of Appeals' "corrected" opinion flatly contradicted a stipulation that the Government had agreed to on the very first day of the eleven-day hearing in the District Court, a stipulation that formed the entire context for the hearing and for the appeal, and which no party to this case, even to the present day, has ever asked to be relieved of:

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* This notwithstanding the fact that various SEC officials, including Stanley Sporkin, Esq., Director of the SEC's Division of Enforcement in Washington, D. C., testified during the District Court hearing.

** The concept of a "preliminary communication" as distinguished from a "criminal reference" (formal or informal) appears to have been coined by the SEC for use in this case for the first (and to our knowledge only) time, and was, at that, coined for the first time in the SEC's amicus brief on appeal.

> "Mr. Bender (Petitioner's Counsel): . . . [W]e would ask your Honor's indulgence to ask the Government if it will stipulate with the Court and for the record, that there isn't any question, whatever, that this case came to the United States Attorney's office in the first instance through a reference by the Securities and Exchange Commission.
>
> The Court: The so-called criminal reference referred to?
>
> Mr. Bender: That is correct." (Tr. 6-7; JA 297)

In response, the attorney for the Government, after outlining the Government's version of what had factually occurred, responded:

> "(The Prosecutor, Mr. Cutner): To sum up, we do not dispute in this hearing that the matter came to the attention of the U. S. Attorney's office from the New York Regional Office of the SEC.
>
> The Court: And I need not concern myself with semantic subtleties as to whether or not what took place was a 'criminal reference', you make no point on that?
>
> Mr. Cutner: I do not.[*]

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* The inevitability of the United States Attorney's concession, in the parties' stipulation in the District Court, that a criminal reference had been made here is apparent on the face of critical findings of fact made by the District Court, not controverted on appeal by the Government, and ignored by the Court of Appeals: the original reference of this case to the United States Attorney's Office was by SEC attorney Perlmutter, who called a friend of his in the United States Attorney's Office, told him "we really want to get" the defendants, but requested that the United States Attorney's Office defer action because the SEC attorneys "first wanted to 'wrap up' the civil settlement"—a request repeated by Perlmutter to the Assistant United States Attorney several times over the next few months (JA55).

The Court: Does that suit your purpose?
Mr. Bender: Yes." (JA 299).

In view of this stipulation* it is not surprising that the District Court found there to have been a criminal reference and that *the United States Attorney's Office—the only Government agency which is a party to this case—did not join or concur in the SEC's amicus memorandum and did not adopt and has not to this day adopted the SEC's position or asked to be relieved of its stipulation.*** Indeed, even as late as in its letter (see p. 24, fn.) sent to the Court of Appeals on October 10, 1978, subsequent to that Court's original opinion, the United States Attorney's Office reiterated its concession that the referral of this case by Perlmutter and Tucker to the United States Attorney's Office had in fact constituted a "criminal reference."

In basing its "corrected" opinion*** on this premise which directly conflicted with the parties' stipulation made

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* This stipulation was pointed out to the Court of Appeals by affidavit of petitioner's counsel subsequent to the filing of the SEC's amicus memorandum and while the petition for rehearing in the Circuit Court was still pending, but was ignored.

** Indeed, the position belatedly asserted in the SEC's appellate amicus memorandum contradicted the position actually taken by the SEC during the course of the hearings in the District Court. In the midst of that hearing, the SEC itself entered an order of referral *nunc pro tunc,* some six months after the indictment, which would have been completely unnecessary and inexplicable if what was involved in this case was a mere "preliminary communication" requiring no Commission approval (JA561, JA174, JA295).

*** It should be noted that the Court of Appeals' original opinion was rendered only after the SEC had submitted a prior amicus brief which, at the Court of Appeals' request, was "limited to a statement of the criminal reference procedure, formal and informal, which was in effect during the period involved in th[is] case."

at the outset of the hearing nearly two years earlier in the District Court and from which no party to this appeal has ever asked to be relieved, the Court of Appeals completely departed from the well-established principle of appellate review enunciated by this Court (see, e.g., *Hackfeld & Co.* v. *United States,* 197 U.S. 442, 25 S.Ct. 456 (1905); *Utah* v. *United States,* 394 U.S. 89, 89 S.Ct. 761 (1969)) and by every other Federal Circuit Court of Appeals that has ruled on the issue (see, e.g. *Gambill* v. *United States,* 276 F.2d 180, 181 (6th Cir. 1960) ("the reviewing court may not set aside a verdict by interfering with a stipulation of fact which the trial court has recognized"); *Schlemmer* v. *Provident Life & Acc. Ins. Co.,* 349 F.2d 682, 684 (9th Cir. 1965) ("when parties have entered into stipulations as to material facts, our [appellate] duty is to treat such facts as having been established by the clearest proof"); *Osborne* v. *United States,* 351 F.2d 111, 120 (8th Cir. 1965) ("Any available relief from a stipulation should be sought in the trial court and request for such relief should be timely. It is too late after the case has been decided on appeal to seek such relief. . . ."); *Verkouteren* v. *District of Columbia,* 346 F.2d 842 (D.C.Cir. 1965); *United States* v. *Star Const. Co., Inc.,* 186 F.2d 666 (10th Cir. 1951)) that on review an appellate court may not upset facts stipulated to and relied upon the parties (in the absence of extraordinary circumstances none of which are, or have been even alleged to have been, present here). Because of this sharp departure from this well-established rule governing appellate review, a writ of certiorari should issue.

5. The Court of Appeals' decision reversing the District Court's dismissal of Counts 1-3 on the alternative grounds overlooks controlling decisions of this Court, decisions of other courts, and the legislative purposes of the statute involved.

The Court of Appeals reversed the District Court's dismissal of Counts 1-4 on alternative grounds. On Counts 1-3, the District Court was found to be in error in concluding as a matter of law that there was no Section 17(a) violation because the alleged non-disclosure of the sale of stock by a group of stockholders (ERD) in April or May, 1971 did not constitute a material non-disclosure in the prospectus issued by TDA on November 10, 1971. Besides holding that the non-disclosure had no impact on the financial condition of the company which could materially affect a decision of a potential purchaser of TDA stock in 1971, the District Court also concluded that (a) as charged in the indictment, the victim of the alleged fraud was ERD, not TDA, and that ERD was the seller and not a buyer protected by Section 17(a), (b) the charge was an attempt to evade the five-year statute of limitations on the crime charged, and (c) the transactions which occurred in April and May, 1971 had no causal connection with the offer and sale of TDA securities in November, 1971.

The Court of Appeals addressed only the question of materiality, holding that under *TSC Industries* v. *Northway, Inc.*, 426 U.S. 438 (1976), "a sufficient basis of materiality" has been shown by the Government to raise an issue of fact. Such a showing was found to exist in the Government's claim that "the ERD kickbacks . . . may well be immediately recoverable by TDA, Inc. as a short-swing purchase and sale under 16(b) of the 1934 Act," even though the Court of Appeals noted that the "Defendants' $300,000 profit on this transaction . . . ultimately [came] out of the pockets of the defrauded stockholders". (102a).

The Court of Appeals did not consider the additional grounds upon which the District Court had concluded that Counts 1-3 did not state a crime. In sustaining the sufficiency of Counts 1-3, all of which related to the non-disclosure in the prospectus of the ERD stock transactions, the Court of Appeals implicitly rejected the District Court's further grounds for dismissing the counts, i.e., that Section 17(a) was not intended to protect alleged defrauded sellers of securities and, further, that the ERD transactions which occurred in April and May of 1971, some eight to nine months prior to the filing of the TDA prospectus in November, 1971, had no connection with that subsequent offer and sale of the TDA securities. In so doing, the Court of Appeals, we submit, wrongly interpreted this Court's opinion in *TSC* v. *Northway* and broadened the scope of Section 17(a) beyond what was intended by Congress and by the decisions of this and other courts. This Court's opinion in *Northway* dealt with an alleged proxy violation under Section 14(a). The constituent elements of a 17(a) or 10(b) action were not before this Court or even considered. The Court of Appeals erred in holding that under *Northway* a valid Section 17(a) claim does not require that the misconduct alleged be in connection with the offer and sale of the TDA securities issued in November, 1971, and further erred in holding that a violation was charged although the sellers of the securities rather than the purchasers were allegedly defrauded.

Section 17(a) prohibits specified schemes of fraud only if they are "in connection with the offer or sale of a security." The alleged ERD transactions which took place eight to nine months earlier played no part whatever in the offer and sale of the TDA securities in November, 1971, as found by the District Court. The District Court was correct because the "in connection" requirement with a stock transaction is an essential element for a violation,

as this Court noted in a Section 10(b) action in *Superintendent of Insurance* v. *Bankers Life & Cas. Co.*, 404 U.S. 6, 92 S.Ct. 165 (1971), where it held a 10(b) violation to exist because the "deceptive practices [touched upon] its sale of securities as an investor." 404 U.S. 12-13. Indeed, even a more direct involvement in the offer and sale of a security must exist under Section 17(a) than under Section 10(b), as this Court noted in *Blue Chip Stamps* v. *Manor Drug Stores*, 421 U.S. 723, 733 (1975). This "in-connection" requirement was re-emphasized by this Court in *Santa Fe Industries, Inc.* v. *Green*, 430 U.S. 462, 97 S.Ct. 1292 (1977), where in declining to sanction a cause of action under Section 10(b)-5 for alleged breach of corporate fiduciary duty, the Court distinguished *Superintendent of Insurance* v. *Bankers Life* as an action involving a "seller [of bonds] duped into believing that it, the seller, would receive the proceeds." 97 S.Ct. at 1301, n. 15. The District Court correctly applied this Court's decisions, as have other courts which have addressed the question and reached conclusions contrary to that of the Court of Appeals below. In *Ketchum* v. *Green*, 557 F.2d 1022 (3d Cir. 1977), the Court of Appeals upheld the dismissal of a cause of action where the relationship between the alleged fraud and the securities transaction was too attenuated and remote to support a 10(b)-5 claim. The Court of Appeals appropriately stated:

> "While the coverage of § 10(b) may well have been intended by Congress to overlap somewhat with that of certain state provisions, it is questionable whether the scope of the statute should be extended to all phases of corporate operations and relationships whenever they entail the incidental involvement of securities. Realistically, there are a multitude of corporate decisions and endeavors which implicate securities in some fashion." 557 F.2d at 1029

Similarly, in *Biesenbach* v. *Guenther*, 588 F.2d 400 (3d Cir. 1978), a 10(b)-5 complaint was likewise dismissed although it alleged that the corporate directors had failed to disclose the true purpose of their authorization for additional shares to be issued by the corporation, which was allegedly to gain control of the corporation by reducing the membership of the Board of Directors and which allegedly constituted a fraud upon the shareholders. The Court of Appeals noted,

> "In effect, appellants are stating that the failure to disclose the breach of fiduciary duty is a misprepresentation sufficient to constitute a violation of the Act. We refuse to adopt this approach which would clearly circumvent the Supreme Court's holding in Santa Fe." 588 F.2d at 402

As charged in the indictment, the ERD transactions, no matter how characterized by the Government to evade the five-year statute of limitations, were a classic example of alleged internal corporate mismanagement for which the State courts have provided a sufficient, adequate, and exclusive remedy. See *Rapaport* v. *Schneider*, 29 N.Y.2d 396, 400, 328 N.Y.Supp.2d. 431, 435 (1972). The decision of the Court of Appeals, however, if permitted to stand, converts a State claim of corporate waste or mismanagement into a Federal cause of action under Section 17(a) of the 1933 Act through the ruse of a conclusory allegation of non-disclosure. Its action in this respect is more in doubt in view of the division on this question that exists in the Court of Appeals for the Second Circuit. Thus in *Goldberg* v. *Meridor*, 567 F.2d 209 (2 Cir. 1977), Circuit Judge Meskill in dissent appropriately noted:

> "Yet under the majority's reasoning the failure to inform stockholders of a proposed defalcation gives rise to a cause of action under 10(b)(5). Thus, the majority has neatly undone the holdings of *Green, Piper* and *Cort* by creating a federal cause of action for a breach of fiduciary duty that will apply in all cases, save for those rare instances where the fiduciary denounces himself in advance. If the defendants have looted UGO in the same manner alleged by the plaintiffs, a full recovery should not be difficult to obtain. Under New York state law, this would be a breach of the fiduciary duty imposed upon directors."

A similar division occurred in *Joyce* v. *Joyce Beverages, Inc.,* 571 F.2d 703 (2d Cir. 1978).

Moreover, a violation of Section 17(a), as the District Court held below, requires a claim that the purchaser of securities was defrauded. Here, the indictment alleged that the seller (ERD) was defrauded and that the petitioner through an intermediary did the defrauding. Indeed, the Court of Appeals emphasized this in stating, "Defendants' $300,000 profit on this transaction . . . ultimately [came] out of the pockets of the defrauded stockholders", i.e., ERD, the seller. Yet as noted in *Birnbaum* v. *Newport Steel,* 193 F.2d 461, 463 (2d Cir. 1952), "Section 17(a) [77q(a) of the 1933 Act] only made it unlawful to defraud or deceive purchasers of securities." See also, *S.E.C.* v. *Guild Films,* 279 F.2d 485, 489 (2d Cir. 1960); *Financial Programs, Inc.* v. *Falcon Financial Services,* 371 F.Supp. 770, 775 (D.C.Ore. 1974). *Cf. United States* v. *Naftalin,* 579 Fed. 2d 444 (8th Cir. 1978) where the Court of Appeals in reversing a conviction charging a scheme to defraud under Section 17(a) rejected the governments contention that Section 17(a) does not require

that a purchaser be defrauded as long as someone is defrauded in the offer or sale of securities, cert. granted December 11, 1978, No. 78-561.

6. In reversing the District Court's dismissal of Count 4 (the proxy count), the Court of Appeals departed from this Court's opinions in *J. I. Case Co.* v. *Borak*, 377 U.S. 426 (1964) and *Mills* v. *Electric Auto-Light Co.*, 396 U.S. 375 (1970).

The Court of Appeals found that pursuant to Section 14(a) of the 1934 Act and Rule 14a-9, the ERD and Westcalind transactions were required to be disclosed in the TDA proxy of December 1971. In doing so, it impliedly rejected the holding of the District Court that there was a complete absence of any connection between the ERD and Westcalind transactions and the matter for which the proxy was solicited. The District Court had held:

> ". . . [N]one of these acts, all of which had been accomplished prior to the stockholders' meeting referred to in the proxy solicitation, bore any direct relationship to the business sought to be accomplished at the meeting, and referred to in the proxy statement. Accordingly, 'transactional causation' resulting from the non-disclosure of those prior acts, cannot be demonstrated."

The District Court relied upon this Court's opinion in *J. I. Case Co.* v. *Borak*, 377 U.S. 426 (1964), where this Court held:

> "The purpose of Section 14(a) is to prevent management or others from obtaining *authorization for corporate action* by means of deceptive or inade-

quate disclosures in proxy solicitation." (Emphasis added) 377 U.S. at 431

The District Court relied further on this Court's opinion in *Mills* v. *Electric Auto-Light Co.*, 396 U.S. 375 (1970), where this Court held that a violation of Section 14(a) and Rule 14a-9 would exist where the misstatement or omission in the proxy statement was material, if "the proxy solicitation itself was an essential link in the accomplishment of the transaction." 396 U.S. at 385. This principle of "transaction causation", established in *Borak* and *Mills*, was reaffirmed by this Court in *TSC Industries* v. *Northway, supra.*

In rejecting the District Court's opinion, the Court of Appeals failed to apply the principles of *Borak, Mills,* and *TSC Industries,* and conflicts with a majority of decisions that have likewise interpreted the requirements of Section 14(a) and Rule 14a-9 as the District Court did below. If allowed to stand, the Court of Appeals' decision will result in a flood of actions in the Federal Court without regard to whether the proxy solicitation was a link in the accomplishment of the wrongs alleged. Numerous decisions relying upon this Court's opinions in *Borak* and *Mills* reflect the error committed by the Court of Appeals below.

In *Epic Industries* v. *Brothers,* 395 F.Supp. 773 (N.D. Okla. 1975), a complaint charging violation of Section 14 (a) and Rule 14a-9 was dismissed for lack of "transaction causation" notwithstanding the claim that the proxy statement failed to disclose that management had approved an illegal and unauthorized loan to an officer and director. Although such an omission would violate Item 7(e)(4) of Sch. 14A requiring disclosure by an officer or director of "indebted[ness] to the issuer . . ." (a rule which the Court

of Appeals held was violated in the instant case), the District Court nevertheless held there was no violation because "these actions [wrongful loans] were taken by virtue of the defendants' position in the corporation and not through an authorization obtained through alleged false proxy statements." 395 F.Supp. at 776. Similarly, in *Oldfield* v. *Alston,* 77 F.R.D. 735 (N.D.Ga. 1978), the District Court dismissed a Section 14(a) claim for failure of "transaction causation", notwithstanding a claim that the defendants failed to disclose in seeking election as directors that they had been stealing from the very corporation they desired to serve. The District Court said, "The alleged [wrongdoings] . . . were not the subjects of the challenged proxy solicitations. . . . If there were any violations by the defendant-directors . . . they represent a breach of the directors' fiduciary duty to [the corporation] and its shareholders rather than a violation of the proxy provisions under the Securities and Exchange Act of 1934." 77 F.R.D. at 744. In *Halle & Stieglitz Filor, etc.* v. *Empress Intern,* 442 F.Supp. 217 (D.Del. 1977), the District Court dismissed the Section 14(a) claim because the alleged non-disclosure of the cash tender offer (which was required to be disclosed under the regulations) "was not a link in the consummation of the alleged coercive tender offer because the offer was not authorized by a shareholders' vote . . . at [the] annual meeting." 442 F.Supp. at 225. Even though the directors had concealed their intent to make a cash tender offer "prior to soliciting proxies . . . for the election of directors at the annual meeting, they were under no duty to disclose that fact in the proxy materials under Section 14(a) or the rules thereunder . . . [because] the solicitation of proxies . . . was for the sole purpose of electing five directors . . . and for ratifying the board's election of independent public auditors and was not for the purpose of voting upon a contemplated tender offer. The law is well settled that

in order to constitute a proxy violation under Section 14(a) and the rules thereunder, an omission or misrepresentation of a material fact must relate to the purpose for which the proxies were solicited." 422 F.Sup. at 223.

Similarly, in *In Re Tennaco Securities Litigation,* 449 F.Supp. 528 (S.D.Tex. 1978), a complaint under Section 14(a) was dismissed notwithstanding a charge that the defendants failed to disclose in proxy solicitations for the election of directors that the candidates for election had dissipated corporate assets by making illegal payments in the form of foreign and domestic bribes and political contributions. Relying on this Court's opinion in *Borak,* the District Court found no "transaction causation" between the alleged misconduct and the proxy solicitation. ". . . Assuming," the District Court held, "that such payments were made and . . . this would be a material omission from the solicitation of an election proxy, the materiality goes only to the election and not to the making of the payments themselves." 449 F.Supp. at 531. Whatever injury the corporation suffered "'[resulted] from a breach of a fiduciary obligation owed as a director or officer rather than from any shareholder vote obtained by false proxy solicitation materials.' Such acts of corporate waste and breach of fiduciary duty form the basis of state claims and do not state a claim under the Federal Securities Laws." 449 F.Supp. at 531.

In sustaining the Government's position and reversing the District Court, the Court of Appeals has violated the general principle that statutes creating crimes are to be strictly construed and before one may be punished it must appear that his case is plainly within the statute. *Untied States* v. *Campos-seserrano,* 404 U.S. 293, 297-298 (1971). This Court recently reaffirmed that principle in reversing the Court of Appeals for the Sixth Circuit

and reinstating the dismissal of the indictment in *Adamo Wrecking Co.* v. *United States,* —— U.S. ——, 98 S.Ct. 566, 572-573 (1978).

In addition to the foregoing, petitioner respectfully adopts all arguments raised in the accompanying petition of co-petitioner Fields.

CONCLUSION

For the above reasons it is respectfully submitted that the petition for a writ of certiorari should be granted.

Respectfully submitted,

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Supreme Court, U. S.
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IN THE

Supreme Court of the United States

OCTOBER TERM, 1978

No. 78-1483

FREDERICK M. FRIEDMAN,
Petitioner,

—against—

UNITED STATES OF AMERICA,
Respondent.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Second Circuit

REPLY BRIEF FOR PETITIONER, FREDERICK M. FRIEDMAN

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REPLY BRIEF FOR PETITIONER FREDERICK M. FRIEDMAN

Because the Government's opposing brief ignores several of the grounds advanced in the petition, inadequately responds to others, and ignores critical and undisputed findings of fact, petitioner herein respectfully replies to the Government's brief. The within brief will refer seriatim to the arguments raised in the petition.

1.

As to the conflict with *United States* v. *Rodman*, 519 F.2d 1058 (1st Cir. 1975).

Our petition (at p. 14-17) set forth the reasons why the purported "distinctions" which the Court of Appeals found to exist between this case and *Rodman* were in fact non-existent and why, upon analysis, those "distinctions" serve merely to highlight the irreconcilable conflict between the First Circuit's decision in *Rodman* and the Second Circuit's decision in this case. The Government's opposing brief (Br.* 13-14) merely restates the supposed "distinctions" relied upon by the Court of Appeals here, and fails even to address the petition's argument that those "distinctions" are in reality distinctions without a difference.

One factor in this regard is now noteworthy. The Solicitor General (at Br. 13) has now joined the District Court and the Court of Appeals in condemning** the out-

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* The letters "Br." followed by a number designate page references to the Government's brief in opposition to the petition for a writ of certiorari.

** The Solicitor General's condemnation, however, is unduly mild. The "misconduct" involved here was not merely "improper" (Br. 13) and did not result in a mere "misunderstanding" (Br. 14); rather, as set forth at pp. 7-12 of the petition, the Government's representatives engaged in a deliberate gross fraud replete with deceptions and concealments and, eventually, capped by perjury at the District Court hearing. Nor was the SEC attorney's affirmative misrepresentation that there would be no criminal reference, which is referred to at Br. 5-6, merely made to an irrelevant third party, as the Solicitor General's brief suggests, but was made to counsel for a prospective director of TDA who fully explained to the SEC attorney the tremendous significance of a truthful answer to the question involved (see petition at p. 10, ¶ 11).

rageous fraud perpetrated by the SEC attorneys on petitioner. Yet, petitioner is, in the Solicitor General's view, to be left without any remedy for this fraud perpetrated on him. The Solicitor General's suggestion (at Br. 14, n. 7) that the Court of Appeals "did not foreclose the possibility" of relief in the civil action is frivolous in view of the undisputed fact—so found by the District Court and unquestioned by the Government on appeal—that no such remedy is in reality a possibility (see petition p. 19, n. **).

Under these circumstances it is respectfully submitted that the District Court did not abuse its discretion* in reaching the sole result—dismissal of substantial portions of the indictment—which would in any respect have tended to remedy the wrong deliberately inflicted on petitioners by the Government's undisputed fraud.

2.

As to the importance of the question of the District Court's supervisory power to remedy a fraud perpetrated by Government attorneys upon a citizen.

The Government's brief fails to address this point directly. Rather, the Government states that review of this significant issue is premature since petitioner has not yet been tried (Br. 7-8). However, the Solicitor General does not dispute that Congress has mandated that review by

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* It should be borne in mind that the issue here presented is whether or not the District Court abused its discretion—as the Court of Appeals held it did—rather than, as the Solicitor General states, "whether the indictment *should have been* dismissed." (Br. 2; emphasis added).

this Court on certiorari at this stage of the proceedings is permissible, and that, therefore, this Court's jurisdiction has been properly invoked under 28 U.S.C. § 1254(1). The Solicitor General's analogy to the non-appealability of interlocutory orders is misplaced since Congress has declined to grant this Court jurisdiction at that procedural posture.

Thus, as recently as last term in *Adamo Wrecking Co.* v. *United States,* —— U.S. ——, 98 S.Ct. 566 (1978) (cited in the Petition (at pp. 39-40) but ignored in the Government's brief), this Court granted certiorari where, as here, dismissal of an indictment by a District Court was reversed and remanded for trial by the Court of Appeals. This case is in the identical procedural posture as *Adamo* was when this Court granted certiorari. See also *Mills* v. *Electric Auto-Light Co.,* 396 U.S. 375, 381, 90 S.Ct. 616, 620 (1970), where despite the reversal by the Court of Appeals and remand to the District Court for a trial, this Court stated, "We granted certiorari . . . believing that resolution of this basic issue should be made at this stage of the litigation and not postponed until after a trial under the Court of Appeals' decision." Indeed, in view of the gross fraud perpetrated on petitioner, to require him to withstand the rigors and tribulations of a criminal trial, if the District Court's dismissal of the indictment was not an abuse of discretion, would be a gross injustice.

3.

As to the SEC's unauthorized criminal reference of this case to the United States Attorney's office.

Subsequent to the filing of the Petition in this case, this Court rendered its decision in *United States* v. *Caceres,* No. 76-1309, 99 S.Ct. 1465 (April 2, 1979). Every factor—without exception—considered by this Court in *Caceres* in assessing the appropriate remedy for an administrative agency's failure to follow its administrative regulations warrants dismissal of the indictment here. The following were the factors held by this Court to be the relevant considerations in determining what, if any, remedy is appropriate in a criminal prosecution for an administrative non-prosecutorial agency's violation of its own regulations:

(a) In *Caceres,* "neither the Constitution nor any Act of Congress requires that official approval be secured . . ." (99 S.Ct. at 1467). In the instant case, to the contrary, regulations with respect to criminal references are dictated by federal statute (see e.g., 15 U.S.C. § 78d-1(a)).

(b) In *Caceres,* the agency's "construction of their own regulations, even if erroneous, was not obviously so." (99 S.Ct. at 1472). Here, the violation of the published regulations involved a gross, undisputed, and obvious fraud.

(c) In *Caceres,* the reason for the failure to follow administrative regulations was perceived to have been time pressures "rather than any doubt about [the agency's action's] propriety" (99 S.Ct. at 1472). Here, the failure to follow the administrative regulations was part and parcel of the SEC attorneys' fraudulent misconduct.

(d) In *Caceres*, "the Executive itself has provided for internal sanctions in cases of knowing violations of the . . . regulations" (99 S.Ct. at 1474). Here, not only is there no provision for internal sanctions, but the SEC itself has effectively advised that no sanctions will be imposed unless the courts do so* (see petition, p. 20).

(e) *Caceres* involved an "occasional erroneous administration" of the regulation (99 S.Ct. at 1474). Here, the Government has conceded that the failure to follow the administrative regulations regarding the making of criminal references is a routine and everyday deviation from the regulations.

(f) In *Caceres*, "the agency action, while later found to be in violation of the regulations, nonetheless reflected a reasonable, good-faith attempt to comply . . ." (99 S.Ct. at 1474). Here, the Government's actions were fraudulent rather than in good faith.

(g) In *Caceres* the defendant did not "suffer substantially because of [the regulations'] violations

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* The Solicitor General's statement (Br. 13, n. 5) that "both SEC lawyers have since resigned their positions with the Government" is misleading if it intends to convey that those resignations were in any manner related to the fraud in this case or were in any manner a result of any sanctions imposed by the SEC. One of the attorneys, Perlmutter, testified at the District Court hearing that he had left the SEC and had entered private practice prior to the hearing itself. There is nothing in the record regarding the circumstances under which the second attorney, Tucker, left the SEC (and the Government's brief indicates no record reference), but not even the Government's brief in its recitation of Tucker's resignation, even without record references, suggests that that resignation was in any way impelled by the SEC itself, or that the SEC regarded either resignation as having been made under circumstances other than highly honorable.

> by the agency", and "no one questions" that authorization would have been obtained (99 S.Ct. at 1372, 1474). Here, had the regulations been followed and the matter proceeded to the levels required prior to a criminal reference, nothing in the record indicates that the fraud perpetrated by the SEC attorneys on petitioner would have been consummated by their more experienced superiors.

Moreover, the Solicitor General's characterization of the regulations governing criminal references is inaccurate. As noted in the petition, the regulations authorize only the *Commission* to make a criminal reference. The regulations cited by the Solicitor General (at Br. 12, referring to Pet. App. 92a-94a) either require *Commission* authorization or contain delegations by the Commission to higher levels of authority than that of Messrs. Tucker and Perlmutter, who made the recommendations here. And as to the one regulation referred to in the Government's brief (at Br. 12) regarding inter-agency cooperation (§§ 171.06 and 171.07 of the Commission's Manual, set forth at Pet. App. 93a), such cooperation is sanctioned in matters "*other than* formal investigations which have been ordered by the Commission"—a proviso especially pertinent to this case where, as noted at pages 23-25 of the petition, there *was* a formal investigation (see Point 4 of petition).

4.

As to the Court of Appeals' ignoring of critical stipulated facts.

Significantly, the Government's brief fails to dispute—or even address—the fact that the Court of Appeals' decision in this case constitutes a sharp deviation from the rule invariably followed by every other federal Circuit Court of Appeals that an appellate court does not have the power to ignore and override critical facts which the parties have stipulated to and do not dispute even on appeal (indeed not even on this Petition). The Government apparently has no answer to Point 4 of the petition.

5.

The reversal of the dismissal of Counts 1-4 on alternative grounds.

The Government, just as does the Court of Appeals, aborts the District Court's decision dismissing Counts 1-3 by directing this Court's attention to a single basis upon which the District Court dismissed the counts, disregarding other basic and fundamental reasons. Lack of materiality of the non-disclosure of the ERD transactions was merely one basis for the District Court's dismissal. The District Court went further and held:

> "As defrauded *sellers* of securities, those shareholders are unfortunately not within the purview of Section 17. This is the dilemma which pervades the public offering counts of the indictment; the illegality charged is basically a Section 10(b) violation in that the injured parties were the deceived sellers of

> TDA stock. A prosecution for violation of that provision would appear to be barred by the statute of limitations, and consequently, the Government has attempted to resuscitate the ERD schemes by portraying them as acts in furtherance of a conspiracy. For the reasons just stated that approach is inappropriate, and the motion to dismiss the public offering counts for failure to state an offense is granted to the extent that the ERD transactions, portrayed in paragraphs 10(f) and 10(g), are stricken." (Pet. App. pp. 49a-50a)

Section 17(a) of the 1933 Act (whether conspiracy or substantive violation) generally speaking makes it unlawful in the offer and sale of securities by the use of the mails to employ a scheme or device to defraud a purchaser of the securities offered or sold. *United States* v. *Cashin,* 281 F.2d 669, 671-672 (2d Cir. 1969); *United States* v. *Amick,* 439 F.2d 351, 358 (7th Cir. 1971); *United States* v. *Saporta,* 270 F.Supp. 183, 185 (E.D.N.Y. 1967). To the extent that the indictment charged that the victim of the alleged fraud was ERD, the seller of the TDA securities, and that the offer and sale of the security involved in the alleged fraud occurred in April or May, 1971, but not in connection with the TDA offer and sale in November, 1971, it was insufficient, as the District Court held, to charge either a conspiracy to violate Section 17(a), or a substantive violation of 17(a), or a Section 1001 violation relating to said ERD transactions. The Court of Appeals was in error, we submit, and so was the Government in ignoring these basic insufficiencies in the indictment on which the District Court relied. The Government's position, as well as the Court of Appeals', is contrary to well-established judicial authority and the statutory purpose. The Government's argument justifies certiorari, not a denial.

The Government's position on the District Court's dismissal of Count 4 is even more surprising since the Government seeks to overcome troublesome judicial authority and legislative purpose by espousing a novel doctrine that "causation" is relevant only in civil actions for damages under Section 14(a) and Rule 14(a)-9 but irrelevant under criminal actions (Br. 11, n. 4).

This startling argument, which is relegated to a footnote, would eliminate from a criminal charge under Section 14(a) (although not in a civil case) the essential elements of Section 14(a) and Rule 14(a)-9. The Government cites no authority, which is not surprising, since judicial authority is all to the contrary. *SEC* v. *Joiner*, 320 U.S. 344, 355, 64 S.Ct. 120, 125 ("where this proof is offered in a civil action as here the preponderance of the evidence will establish the case; if it were offered in a criminal case, it would have to meet the stricter requirement of satisfying the jury beyond a reasonable doubt"); *Mallis* v. *Federal Deposit Ins. Corp.*, 568 F.2d 824, 829 (2d Cir. 1977), *cert. dis. Bankers Trust Co.* v. *Mallis*, 98 S.Ct. 1117 ("The fact that *Gentile* was a criminal case in which civil standing was not an issue does not diminish its persuasion as a precedent with respect to the Section 10(b) claim before us. The existence of a 'sale' is as essential to a criminal prosecution for violation of Section 17(a) as it is to a civil action under that section. We find no basis on the face of either the 1933 Act or the 1934 Act of denominating a pledge as a 'sale' for criminal but not for civil purposes"). This Court made no such distinction in *J. I. Case Co.* v. *Borak*, 377 U.S. 426 (1964); *Mills* v. *Electric Auto-Light Co.*, 396 U.S. 375 (1970); and *TSC Industries* v. *Northway*, 426 U.S. 438 (1976). What was held by this Court to be essential in order to constitute a violation of Section 14(a) and Rule 14(a)-9 was that "the proxy solicitation itself was an essential link in the

accomplishment of the transactions". *Mills* v. *Electric Auto-Light Co.*, 396 U.S. *supra* at 385. Based on those decisions as well as substantial other judicial authority (cited in the petition, pp. 36-39), the District Court was plainly correct in dismissing Count 4 because, as it held, ". . . none of the [alleged illegal] acts, all of which had been accomplished prior to the stockholders' meeting referred to in the TDA proxy solicitation, bore any direct relationship to the business sought to be accomplished at the meeting, and referred to in the proxy statement. Accordingly, direct 'transaction causation' resulting from the nondisclosure of those prior acts cannot be demonstrated."

Unless this Court grants certiorari, the Court of Appeals' decision will emasculate the requirements of a charge under Section 17(a), and will broaden and extend its scope beyond the intent of Congress and contrary to decisions of this Court and the weight of judicial authority.

Finally, the Government urges the correctness of the Court of Appeals' decision in reversing the dismissal of Count 4 with respect to an alleged violation of Item 7(f) of Schedule 14(a), which requires disclosure in a proxy of a transaction with "any of its subsidiaries" in which a director or an officer had a direct or indirect material interest. The Government contends, as did the Court of Appeals, that the "Westcalind kickback transaction had to be disclosed under this standard", because Westcalind was a subsidiary of TDA (Br. 3, 11). The District Court found as a fact, however, that TDA owned only 34% of the stock of Westcalind which it held as an investment, that Westcalind's operations were not consolidated with TDA's for financial reporting purposes, and that under SEC rules consolidation of TDA's and West-

calind's operations would have been improper "since TDA owned less than a majority of Westcalind's outstanding stock" (App. 77a). Not a shred of evidence to the contrary was adduced by the Government in the District Court or in the Court of Appeals. In no way, therefore, would Proxy Rule 7(f) of Schedule 14(a) support the correctness of the Court of Appeals' decision as urged by the Government. In disregarding the District Court's findings of fact and conclusions of law that prove conclusively Westcalind was not a subsidiary of TDA, the Court of Appeals and the Government would sustain a charge of crime for an alleged non-disclosure in the proxy statement of alleged improper acts which are clearly not within the purview of Item 7(f) of Schedule 14(a) (issued pursuant to Section 14(a) of the Securities Act).

In addition to the foregoing, petitioner respectfully adopts all arguments contained in the brief of co-petitioner Fields.

CONCLUSION

For the above reasons and for the reasons set forth in the petition, it is respectfully submitted that the petition for a writ of certiorari should be granted.

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